MENTERI KEUANGAN
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INDONESIA INFRASTRUCTURE SUMMIT 2005

PUBLIC PRIVATE PARTNERSHIP
FOR INFRASTRUCTURE

"Bridging the Financing Gap"

By

Minister of Finance
of the Republic of Indonesia

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MINISTER OF FINANCE PRESENTATION
AT THE INFRASTRUCTURE SUMMIT
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Mr. Chairman
World Bank Regional Vice President, Mr. Jemal-ud-din Kassum
Ms. Shamshad Akhtar, Director General, Southeast Asia Department, ADB
Distinguished Delegates
Ladies and Gentlemen

You have heard earlier from the Coordinating Minister for Economy on our economic prospects and the State Minister for Planning and Chairman, National Development Agency on our infrastructure development plans.

It would be clear from those presentations that we need substantial financial resources to meet our infrastructure requirements that are essential pre-requisites to sustain our economic growth and generate new employment opportunities.

Since the Asian crisis from late 1997, we have been preoccupied with macroeconomic reform and financial sector restructuring and we have had very little remaining resources to invest in new infrastructure. With the return of political and macroeconomic stability, we are facing infrastructure 'bottlenecks' that can threaten our growth potential.

We seek to join the growing list of countries where infrastructure investment is substantially supported by the private sector. There are now many international examples of this process working because the risks are being well managed by the public and private sectors according to the system's capacity to mitigate.

The Coordinating Minister had explained earlier that infrastructure development would be our key development priority. Our estimates show that over the next ten years, we need about $83 billion to invest in electric power, roads, telecoms, transport, water and sanitation facilities. From the budget, we are likely to be able to allocate about 22 per cent for infrastructure development. The rest would have to be raised from other sources.

Official Sources of Financing

We look to the World Bank and the Asian Development Bank, our two reliable multilateral development partners, to provide about 10 per cent of our financing needs. The two agencies provide longer tenure financing on slightly concessional terms relative to private sector financing. Their financing is particularly important for our social sector projects such as water supply and sanitation where we can pay special attention for improving basic services to the poor.

The two agencies will also play an important catalytic role in mobilizing private sector investment. The World Bank and affiliate, International Finance Corporation (IFC) and ADB private sector loan operations that can extend loans without government guarantee, or other operational modalities to improve the terms of private commercial loans. At the same time, we will look to their technical assistance support in areas such as regulatory framework, technical feasibilities and best practices as we develop our infrastructure program.

In addition, we can look to the World Bank and ADB to provide partial risk guarantee to cover the performance risks of public utilities and non commercial risks such as expropriation, transfer restriction, breach of contract and civil disturbances. Such coverage may mitigate some risks in place of government guarantee. I will discuss these later.

Government Policy on Guarantee

I should like to deal with an important issue of special interest to investors.

We had disastrous and costly experiences with “Guarantees” or similar instruments under pre-crisis public-private projects, particularly in the power and energy sector. From the lessons learnt, the financial community would expect nothing less from our Government but to maintain disciplined fiscal prudence to assure our continued fiscal sustainability and macroeconomic stability.

In this connection, we welcome all forms of technical and financial cooperation arrangement with the private sector. With respect to Government policy on guarantee, we will follow an “adaptive and pragmatic” policy for private infrastructure projects.

In principle, we would only extend guarantee on Government performance and regulatory risks in well defined areas and where it is absolutely necessary to complete the transactions for priority private projects. This will only be offered after we have completed a comprehensive assessment of the risks, quantify the public contingent liability, and accept that other forms of mitigating instruments are not available to cover such risks.

We will also work with investors to explore guarantee instruments with the World Bank and ADB on financing and/or partial guarantees in select transactions to support our undertakings. If public guarantee is needed for political and government performance risk, we will define clearly what risks should appropriately be guaranteed or counter-guaranteed by the Government and over what period of time.

In this connection, we have requested the World Bank to help us develop a Risk Allocation and Risk Mitigation Framework which would offer the guiding principles and evaluation techniques for privately funded project proposals.

In line with our efforts to promote sustained project commercial viability and minimize our fiscal contingent liabilities under guarantees, we will prioritise sector policy reforms, and develop stronger independent regulatory capacity, to improve the enabling environment for public-private projects.

Fiscal Policy

I now turn to our fiscal policy on mobilizing funds to support infrastructure development.

Increasing Government Spending

The current level of public infrastructure investment at $1.5 billion in 2002 is less than a quarter of the $8 billion in 1994. We estimate that to maintain our growth target of 6 per cent annually, we need additional infrastructure investment of $5 billion (2% of GDP) annually. In the current fiscal consolidation phase, we have limited room to increase our public expenditure. The additional financing requirement could only materialize if we can secure other sources of financing, including borrowings and private investment.

Since 2001, we have transferred a substantial portion of development resources to local governments under decentralization. Eventually, we hope our local governments could step up their local expenditures and invest in infrastructure. For now, however, limited capacity is impeding their infrastructure expenditures. Our local governments generally need substantial capacity building to fully exercise their municipal responsibilities in local development.

Mobilizing Domestic Finance

Our capital market is a potential source of substantial local resources that we can mobilize. We have three large pension funds, namely ASABRI (pension fund for security and military personnel), TASPEN (civil service fund) and JAMSOSTEK (provident fund of private sector employees and in state enterprises) and a large number of private funds established by individual employers and the life insurance sector.

The World Bank, ADB and Australia are assisting the Capital Market Supervisory Agency, BAPEPAM, to improve the regulatory and supervisory framework and develop the domestic bond market to use such resources for investment, including in infrastructure. This will be important source of mobilizing domestic capital for private infrastructure investment.

In some countries, the municipal financing facility is an important source of financing for local infrastructure. As stated earlier, we need to improve the capacity of our local governments before such a financing scheme can be effective.

We are studying the possibility of establishing a secondary mortgage market facility to develop the housing sector. This is still in its preliminary stage.

Increasing Private Sector Participation

Two thirds of our infrastructure funding needs of about $55 billion over the next five years would have to come from international investors/lenders since non-private sources of funds are clearly insufficient to meet the huge financial requirement.

Recent surveys by the World Bank and others reveal that investors are very cautious on entering the Indonesian market, especially in the power and energy sectors due to legal and regulatory uncertainties.

We are going all out to restore private investors' confidence. In infrastructure development, we will establish a framework for risk mitigation and sharing to attract the private investment. In this connection, I will shortly outline our policy regarding the risk sharing in two of the key infrastructure sectors, namely power and roads.

Policy on Risk Sharing for Private Power

We will follow the commonly accepted principle of risk sharing**: where risks be allocated to the party that can best manage and mitigate them at the lowest cost**. This will apply to all infrastructure projects involving private sponsorship and financing. We will be developing methodologies for measuring and integrating the costs of government guarantees, if any and their direct and indirect liabilities on the national accounts.

I like to go through briefly our broad principles on the risk sharing framework for evaluating requests for public support for power generation.

Construction and Completion Risks

On physical delays and cost overruns that are normally addressed through contractual provisions, and commercially instruments are normally available to mitigate such risks.

Operational / Facility Performance Risks
Risks associated with operation and performance of the power plants can be mitigated through TA contracts, O & M and commercial insurance coverage. risks.

Fuel Risks

The issue of fuel supply and fuel price risks is linked to the various sector implementing measures. The mitigation of such risks has to be carefully examined on case by case basis and likely to b shared between the Government and the project entity.

Political, Regulatory and Currency Risks

The Government would consider bearing the cost of such risks where it has control over public policies and regulatory risks.

PLN Performance Risks

This involves PLN repayment capacity and its financial performance under a power tariff set by the Government. The issues are complex including the mechanism on tariff setting and subsidies, where applicable, to cover lost revenues by PLN.

Force Majeure

The new Investment Law with adress this. In addition, the Government and project promoters can explore with MIGA to cover political risks associated with force majeure.

Government Support for Toll Road Projects

Let me turn to toll roads financing and support from the Government.

The Road Law 2003 was approved last September. The Law provides for the separation of policy and regulation with the establishment of an independent regulatory body. This is an opportunity for the private sector, including potential investors, to contribute to the drafting of the implementing regulations, including tariff setting as a framework to guide privately funded road projects.

The Government is committed to tackle the complex sector issues relating to road network conditions and expansion, maintenance, access for remote communities and funding. The public fiscal resources are clearly inadequate to meet sector requirements and private investment must be brought in.

There are many complex issues inhibiting private investment in toll road development. Private interest in toll roads suffered setbacks when several projects were cancelled and others subject to review following the financial crisis of late 1997. As a result, there has been very little expansion of the road network since the crisis.

The implementation regulations being drafted under the new Road Law will severely cut back the multiple roles of Jasa Marga as road developer - as development agent to construct commercially non-viable road networks, as awarder of concession agreements to private sector and public-private partnership. Other implementing regulations are also under preparation and this is an opportunity for private investors to contribute to their formulation.

From the perspective of the Ministry of Finance, institutional and regulatory reforms will not by themselves be sufficient to attract new private investment into the sector. There are justifiable reasons to provide public support for private toll road investments using the framework on risk allocation and risk mitigation developed for the power sector. Such a framework would allow careful analysis on public-private partnership on toll road development.

The Government would work with the World Bank and others to strengthen the Ministry of Finance’s capacity to analyse issues related to public support and the development of an accounting framework to account for government support in the debt and budgeting process.

The ADB is assisting us in a study on land acquisition and re-settlement issues and the recommendations will be discussed at an inter-ministerial forum shortly. We recognize the concern of private investors in the timely resolution of related issues on land acquisition.

Summary

The Government is committed to accelerate infrastructure development to support economic growth. Private investment is very much needed to achieve our investment targets. We are prepared to discuss in substantive detail, based on specific financing proposals, just what our Government can offer to realize a mutually beneficial public-private project in any infrastructure sector.

I am looking at setting up a small unit within the Ministry of Finance, with World Bank support, to work with the other ministries, regulatory agencies and project proponents to analyse and review the assistance we can extend to expedite the finalizing arrangements involving public sector support.

Thank You